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LONG-TERM PROJECTIONS FOR CALIFORNIA: WILL THERE BE ENOUGH HOUSING?

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A recurring theme in recent years has been that of a looming “housing crisis” in California. During the seven-year period of 1991-1997, California housing production averaged only 96,000 units annually. In the early years of the decade, home prices were falling and people were leaving the state, so limited housing construction made some sense. More recently, however, California's economy has been booming but housing production has managed only a modest expansion.

Is there a crisis? A former UCLA professor once quipped, in response to a similar question: “What crisis? Doesn’t everybody live someplace?” We can’t argue with the literal truth of that statement, but the problem is, we are all pigs (“upwardly mobile” is a nice way of putting it), and seeking to better our living situations. Our housing expectations continually outpace the current reality.

A relevant question for policy is, at what point does the limited supply of new housing impose a constraint on economic growth? The answer is, probably last year; maybe the year before that. We provide evidence below that job growth in Silicon Valley has slowed to a crawl; it is our assertion that not all of this slack is due to the slowing of the world economy. There is increasingly no room in the Silicon Valley for new residents, and outlying areas will have to absorb more of the incremental growth of the Valley’s core high-tech businesses.

The New California Will Be 50 Percent More Populous by 2020

A new population surge in California has already begun. The long-term projections for the California economy in this report are premised on recent evidence that the state's strong performance since the mid 1990s is inducing strong population inflows. The growth trend through 2020 will induce continued net inflows of new migrants, attracted by job opportunities and (we hope) appealing lifestyles.

From 1998 to 2020, California's population will increase from an estimated 33.7 million to 49.4 million. The increment during those 22 years, 15.7 million souls, is equivalent to adding in California's 1960 population. During the late 1950s and early 1960s, private residential building permits averaged about 200,000 per year. Even with lower household formation rates during the next two decades, the 1960s-era construction pace would probably translate to 500,000 units per year, roughly twice what we are projecting. The gap between 500,000 and 200,000 suggests a future housing crunch.

Projections of Population Growth

California's rate of population growth, currently about 2%, will average about 1.9% annually from 2000 through 2010, moderating to 1.6% from 2010 through 2020. During the

California Population Projections

Region	Population (thousands)				Annual Growth Rates (%)		
	1996	2000	2010	2020	1996-2000	2000-2010	2010-2020
Bay Area (9 counties)	6,608	7,136	8,187	8,916	1.9	1.4	0.9
Bay Adjacent (7 counties)	1,700	1,901	2,452	3,022	2.8	2.6	2.1
Sacramento (5 counties)	1,741	1,896	2,381	2,867	2.2	2.3	1.9
Los Angeles County	9,220	9,733	10,851	11,913	1.4	1.1	0.9
San Diego County	2,738	3,005	3,588	4,179	2.4	1.8	1.5
Rest of So. Cal. (4 counties)	6,453	7,028	8,999	10,995	2.2	2.5	2.0
Central Coast (2 counties)	634	665	773	882	1.2	1.5	1.3
Central Valley (6 counties)	2,207	2,476	3,337	4,310	2.9	3.0	2.6
Rest of Calif. (23 counties)	1,277	1,379	1,705	2,039	1.9	2.1	1.8
California Total	32,578	35,219	42,274	49,122	2.0	1.8	1.5

three decades prior to 1990, California's civilian population grew more than 2.1% per year, while the nation's annual rate of population growth was a full percentage point lower at 1.1%.

The driving force behind this population wave in California was a strong inflow of new residents from other states and from abroad. In the decade of the 1980s, net immigration averaged 337,000 annually. Following a period of recession-induced net outflows from 1993-1995, positive net immigration resumed and will likely exceed 300,000 again in 1998 and 1999. For the decade ending in 2010, net immigration is projected to average about 310,000 per year, falling to about 260,000 annually for the decade ending 2020. The other major component of population growth, natural increase (the net of births and deaths), will average about 1% of the population during the projection period. In the table on the following page, growth rates are summarized for nine regions of California and the State as a whole for the period 1996 through 2020.

Highlights of the population projections are:

- The highest rates of growth will occur in the areas adjacent to the nine county Bay Area and in the Central Valley. Wages in the Bay Area are well above the state average, and will continue to draw migrants to the area. The high cost of land in the Bay Area will stimulate housing construction in the counties within commuting distance of the Bay Area over the next several years. The Central Valley will see growth based both on its proximity to the Bay Area and Sacramento and to high rates of population growth from natural increase.
- In Southern California, Riverside, San Bernardino and San Diego counties will continue to see high rates of growth. Employment growth in the high tech industries of Orange and San Diego counties will contribute to this growth.
- Los Angeles County and the Central Coast (Santa Barbara and San Luis Obispo counties) are the areas with the lowest rates of growth in the next decade, joined by the Bay Area in the last decade.

Labor Force, Employment, and Unemployment

As has been true throughout much of its history, California's ability to attract new residents will somewhat exceed its long-term capacity to fully employ them. The state's unemployment rate, currently 1.1 percentage points above the national jobless rate, will exceed the national unemployment rate for most of the projection period, averaging 6.0% for the ten years ending 2010, versus 5.7% for the nation, about as close to parity as California has ever been for a period as long as a decade. During the thirty years from 1960-1990, a period of when the state grew much faster than the nation, its unemployment rate averaged 7.0% versus 6.1% for the nation.

Nonfarm employment will increase about 50% from 2000 through 2020, growing at a sustainable rate of about 2.1%. Most of the increment will be in the state's service-producing sector, including services, wholesale and retail trade, and government. The service-producing sector will increase its share of nonfarm employment from 81.5% in 2000 to 87% in 2020.

Goods-producing jobs, encompassing construction, mineral extraction, and manufacturing, have historically experienced strong productivity growth and will increase only moderately, averaging about 0.3% annually.

Personal Income and Taxable Sales

In real terms, personal income and consumer spending (as measured by taxable sales) will likely not compare to the growth experience of 1960-1990, before California was hammered by the loss of much of its high-wage defense business. Growth of real personal income averaged 4.3% annually during the thirty years from 1960-1990; only in the relative boom years of 1995-1998 has it resumed that expansion. With a moderation of job growth from 1999, the trend will be about 2.8% from 2000-2020.

Real taxable sales are projected to gain 3% annually during the period of 2000-2020. Consumer spending in California has been playing catch-up for several years following its precipitous plunge from 1989-1993, when it declined nearly 13% in real terms and took nearly seven years to regain its 1989 level. Even with the current expansion, real sales will likely average a growth rate of only 1.6% annually for the 1990s. From 1960-1990, the average increase was 3.6% annually.

Housing Supply: Quantity and Affordability Considerations

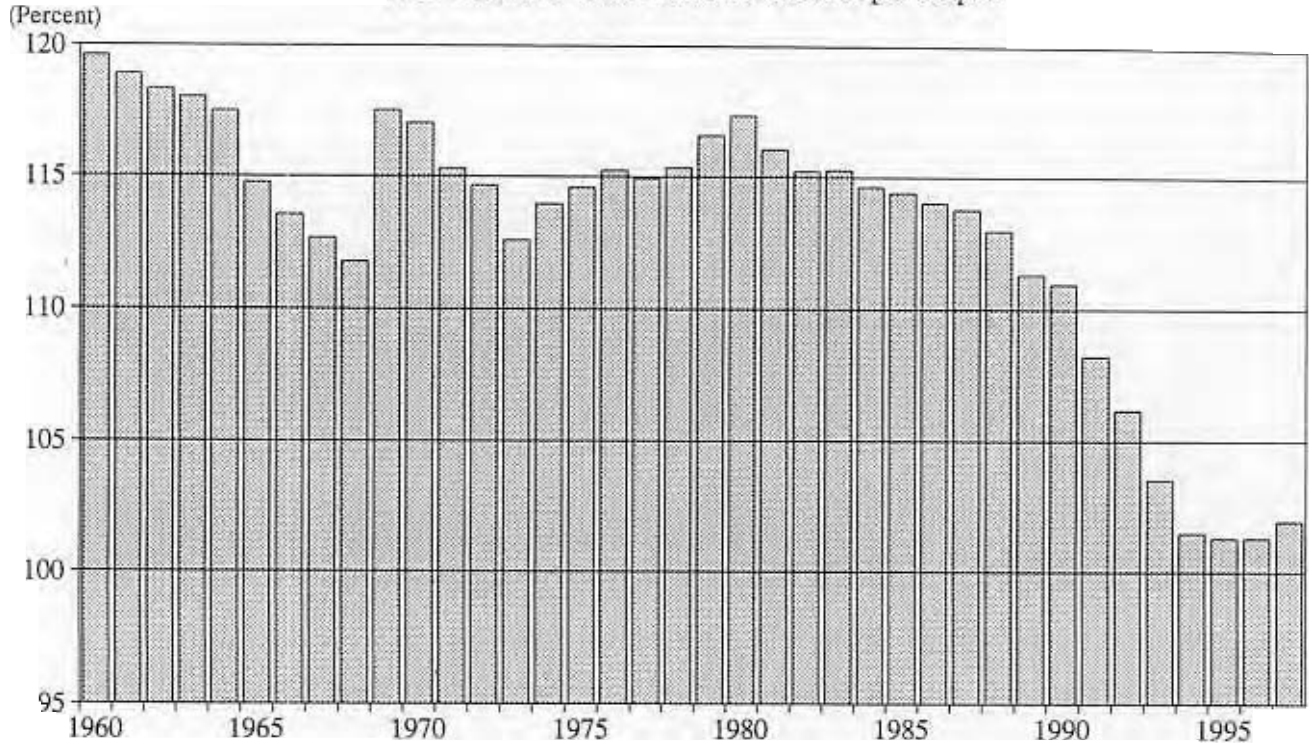
Residential building permits in this forecast will increase from the 129,000 units forecast for 1998 to 185,000 by 2000, increasing to about 270,000 by 2005 and remaining at approximately that level through 2020. This level of home building, quite strong compared with recent production, will nevertheless be less in relation to population than for all but a few years from 1963 (when our data on permits begin) through 1990, notably the early 1980s when mortgage interest rates were high. The lowest number of new building permits in relation to population was recorded in 1995, the year when California's economic slump of the early 1990s finally was reversed.

The supply of affordable housing is tight in most regions, and home prices are high and rising in all major urban areas. Where affordable housing is available, anecdotally in areas like Riverside in the south and Tracy in the north, it is fueling boom-like conditions. The incentives appear to be in place for higher production: low mortgage interest rates, favorable construction financing, strong effective demand (and even stronger demographics), and good long-term growth in employment and income.

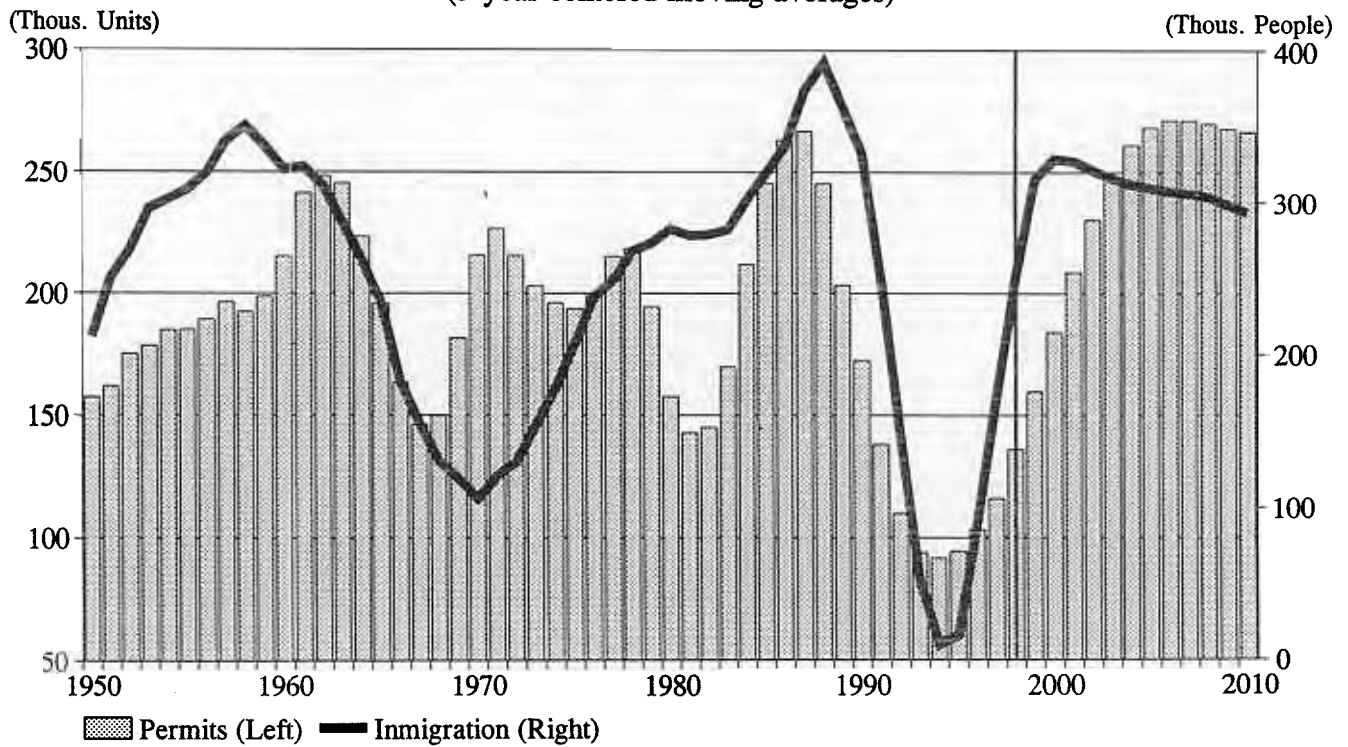
The Clash: High Housing Costs and Average Incomes

During the second quarter of 1998, as measured by the Federal Housing Finance Board, home prices in California's major metropolitan areas were much above national averages: 43% higher in the Los Angeles region, 45% higher in San Diego, and 93% higher in the San Francisco Bay Area, which is now the most expensive residential market in the nation.¹ Housing affordability is now limiting growth in the San Francisco Bay area, and threatens to impinge on the expanding economies of the Los Angeles and San Diego regions. These price increases

California Personal Income per Capita As Percent of U.S. Personal Income per Capita



Residential Building Permits and Net Immigration (5-year centered moving averages)



reflect the collision between strong job-driven residential demand and limited incremental housing supply.

Supply of rental housing is comparably scarce. The Center on Budget and Policy Priorities, an advocacy group based in Sacramento, recently surveyed availability of rental housing for families at or below the poverty level. Not surprisingly, of the 45 largest metropolitan areas in the nation, the six lowest-performing areas in providing affordable rental housing were all in California. The study noted that "The acute lack of affordable housing in California has major negative implications for the prospects of hundreds of thousands of families transitioning from welfare to work."²

Although California home prices have long been well above national averages, so, too have been incomes. In 1960, per capita income in the state was nearly 20 percent higher than the national average. In 1997, however, the California measure was only about 2% above the national average, and had fallen from 10th place in 1992 to 13th place in 1997.³

How did California income per capita fall close to the national average? The most pronounced drop in the California-to-U.S. ratio occurred in the period of 1990-1994, when defense-related manufacturing employment in the state ("aerospace") declined approximately 147,000 jobs (with the highest education and salary levels in manufacturing industry), which produced an additional loss of 235,000 jobs (UCLA-BFP estimate) in other industries, many of which were also high-paying (e.g., finance, real estate, law, accounting, engineering/management consulting).

All major metropolitan areas of Southern California declined in the national rankings, based on personal income per capita, from 1992 to 1996: Los Angeles-Long Beach, from 52nd to 75th; Orange, from 19th to 27th; Riverside-San Bernardino, from 220th to 275th; San Diego, from 75th to 91st; and Ventura, from 41st to 57th.⁴

Even in the San Francisco Bay Area, with two of the highest-income metropolitan areas in the nation (San Francisco ranked first and San Jose fourth in the nation in personal income per capita in 1996) housing affordability has become a constraint on economic growth. The 1998 survey by the organization Joint Venture Silicon Valley reported that, even with an average household income of \$101,010, only 37% of Silicon Valley households could afford to purchase a median-priced home, compared with 65% nationally.⁵

They Are Coming Whether We Like It or Not

The economic and demographic projections in this long-term forecast implicitly assume that many areas of the state will be more intensely developed during the next twenty years. Obviously, there is widespread resistance both to new urban development and to more intensive development of existing population centers. Since conflicts over land use typically occur at the local level (zoning boards and related commissions are most often municipal entities), the accommodation of a large amount of new development will be the product of thousands of separate local regulatory decisions, a lesser number of state and regional legislative measures, and even fewer federal measures such as taxation or reclamation policy.

At one extreme, the city of Santa Barbara may serve as the stereotype of anti-growth sentiment in the state. However, curbs on residential development are seldom as restrictive in larger areas with more diverse populations as they are in Santa Barbara. A more interesting example for our purposes may be the Central Valley region of the state, which is where we are projecting the highest population growth rates through 2020 and beyond.

Mittelbach et al (1997) studied land use in a Central California region equivalent to our regions of the Central Valley and Sacramento. The authors found that the shift of rural land (not all agricultural) to urban usage was generally accompanied by increased agricultural productivity and higher total farm output. One implication of their study is that strict preservation of farmland, if not done with farm policy in mind, could have counterproductive consequences. Ultimately, restrictive measures advocated by anti-development forces might serve neither the objectives of developers and urban populations nor those of agribusiness interests.⁶

Solve the Problem or Risk California's Future Prosperity

Forecast Director Larry J. Kimbell has advocated a radical approach to problems of congestion in areas such as Silicon Valley where growth has been limited by scarcity of developable land, excess demand for highly specialized labor, and other resource constraints. Kimbell has proposed that California pioneer "new strategies for working, living, and communicating." These strategies included such measures as relocating workers and workplaces to less congested areas, and utilizing internet-related technology to reduce job-related mobility requirements.⁷

Stephen Levy of the Center for Continuing Study of the California Economy has published projections of California population and employment which are very similar to our results, and has identified similar implications for land use policy.⁸ Kimbell and Levy both stress the importance of regional approaches to land use, more efficient use of space (often implying higher population density), and fiscal reform for the funding of new infrastructure.

The alternative to some combination of the strategies outlined by Kimbell and Levy will likely be that (1) California will lose out in competition with out-of-state locations for the kinds of cutting-edge activities which have made our economy the envy of the world, and (2) we will still have the congestion, but with higher unemployment and other undesirable externalities. In short, housing and congestion are California's biggest economic challenges over the next two decades.

Endnotes

¹ Federal Housing Finance Board, "Terms on Conventional Home Mortgages," FHFB News, July 27, 1998.

² Center on Budget and Policy Priorities, In Search of Shelter - The Growing Shortage of Affordable Rental Housing for Low Income Families, 1998.

³ U.S. Department of Commerce, "Estimates of Local Area Personal Income," Survey of Current Business, April 1994, and May 1998.

⁴ Ibid.

⁵ Joint Venture Silicon Valley Network, 1998 Index.

⁶ Mittelbach, Frank G.; Fletcher, Robert; Moscové, Brenda; and Wambem, Dennis, "Land Use Competition and Public Policy at the Rural/Urban Fringe: California's Great Central Valley", presented at Regional and Urban Development Conference, Victoria University, Wellington, NZ, December 1997.

⁷ Kimbell, Larry J., "Let's Mobilize California", presentation to the UCLA Anderson Forecast Conference, December 1997.

⁸ Levy, Stephen, Land Use and the California Economy. Center for Continuing Study of the California Economy, 1998.